



# LAW MEMO

## Taking IRS Form 990 Seriously

Do you know where your IRS Form 990 is? Chances are, it's posted on the Internet (e.g., [www.guidestar.org](http://www.guidestar.org)). Now that the forms are so widely available, their importance is increasing dramatically. That's why efforts are underway to encourage nonprofits to be more vigilant about filing accurate and complete returns.

Annual 990 returns serve many purposes. They are used to monitor compliance with the Internal Revenue Code. Thirty-five states (including Illinois but not Missouri) require organizations to file copies with the Attorney General.

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This issue of *Arts Law Memo* outlines who must file and when; describes, in general terms, the information that is reported on the form; summarizes the new disclosure regulations; describes how the form and instructions may be revised in the coming years; and compares six types of financial reports from a grantmaker's point of view.

### THE BASICS

Tax-exempt organizations with total income of \$25,000 or more are required to file IRS Form 990, *Return of Organization Exempt from Income Tax*. Organizations with less than \$100,000 in income and less than \$250,000 in assets can file the 990-EZ Form, *Short Form Return of Organization Exempt from Income Tax*. Schedule A and the new Schedule B, which lists contributors, must be attached to both the 990 and 990-EZ forms.

Even though your nonprofit arts organization is recognized as tax-exempt, it may still be liable for tax on the net income derived from commercial activities that are not substantially related to your tax-exempt purpose or functions. This tax, called the unrelated business income tax (UBIT), was enacted to prevent tax-exempt organizations from having an unfair advantage over for-profit enterprises that offer the same goods or services.

Within reason, there is nothing illegal or unethical about having unrelated business income; your organization simply pays taxes at the corporate rate when the net income of those activities exceeds \$1,000. Unrelated business income is reported on Form 990-T, *Exempt Organization Business Tax Return*.

Your organization's 990 form is due 4.5 months after the close of your fiscal year. So if your fiscal year ended June 30, the form is due on November 15. An organization that fails to file a required return is subject to a penalty of \$20 a day for each day the failure continues. To obtain an automatic extension, use the new Form 8868, *Application for Extension of Time to File and Exempt Organization*.

IRS forms and instructions can be downloaded from the Internet ([www.irs.gov](http://www.irs.gov)).

### WHAT'S REPORTED

The 990 includes several sections:

- Part I: *Revenues, Expenses, and Changes in Net Assets or Fund Balances*. Among the

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VLAA helps artists and arts organizations solve and avoid legal and accounting problems by:

- Making referrals to lawyers and accountants;
- Mediating arts-related disputes;
- Publishing *Arts Law Memo* and concise how-to guides;
- Sponsoring seminars and public forums;
- Arranging for guest speakers;
- Maintaining a reference library;
- Operating an arts space clearinghouse;
- Supplying model contracts and other arts law and business materials;
- Facilitating meetings;
- Conducting and disseminating research on issues affecting the arts;
- Contributing articles to publications;
- Collaborating on arts advocacy initiatives;
- Matching volunteers with arts organizations seeking board members; and
- Providing access to the national VLA network.

This issue was written by Sue Greenberg, VLAA's executive director.

*This publication is distributed with the understanding that VLAA is not engaged in rendering legal or accounting counsel. We urge you to seek professional services to address your specific needs.*

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items reported in this section are the net income or loss from special events and the net income from the year.

- **Part II: *Statement of Functional Expenses*.** This section allocates expenses into three functions: program services, management and general, and fund raising. If the percentage for programs appears too low, donors might question the cost effectiveness of your programs or overall operations.

- **Part III: *Statement of Program Service Accomplishments*.** Be sure the limited space provided is used to tell your "story."

- **Part IV: *Balance Sheet*.** This section reports cash on hand at the beginning and end of the year. It also shows the proportion of income that is temporarily and/or permanently restricted and reconciles the differences between 990 reporting and the guidelines used for audits.

- **Part V: *List of Officers, Directors, Trustees and Key Employees*.**

- **Part VI: *Other Information*.** This section included the value of in-kind contributions, among other information.

*Schedule A* includes compensation information on staff members who are paid more than \$50,000, compensation paid to the five highest-paid independent contractors hired in the past year and sections on lobbying expenditures.

The Support Schedule contains columns to report four years of fiscal information and requires an attachment listing the names of and amount contributed by major donors.

Organizations must file the new *Schedule B* if they receive contributions, gifts, grants, or any similar amounts of \$5,000 or more from any single contributor.

#### **DISCLOSURE REQUIREMENTS**

Regulations that went into effect in 1999 require tax-exempt organizations to make their three most recent annual 990 returns and their applications for tax-exempt status available upon personal request or within 30 days of any written (including e-mail) request.

Organizations are allowed to charge a small fee for reproduction and

## **Why are 990 forms important?**

- **Compliance.** Filing an accurate and complete Form 990 with the IRS and state charity officials is the law.

- **Public Accountability.** With the new IRS regulations, anyone can request a copy of any nonprofit organization's Form 990.

- **Public Relations.** The Internet is making the Form 990 more widely available than before.

- **Primary Source of Data.** Form 990 is the most commonly used data source about nonprofit organizations.

- **Policy Making.** Accurate Form 990 data will help policy makers develop the most effective ways of helping the nonprofit sector, and allow nonprofits to better defend themselves against ill-advised legislative activities.

*Source: Urban Institute, Quality 990 Reporting Project*

postage. They are subject to a \$20 fine for each day they fall behind in providing the forms, up to a maximum of \$10,000 per return. In addition, a \$5,000 penalty for "willful failure" may also be applied. Organizations are not required to provide the names and addresses of contributors or copies of Form 990-T.

Some organizations satisfy the "widely available" requirements by posting their documents on the Internet, either on their own site or on another organization's web page. The documents should be available without a fee and should be in a format that, when accessed, downloaded, viewed and printed, exactly reproduces the image of the application for tax-exempt status or the 990 form as it was filed (except information that is permitted by statute to be withheld).

#### **FORM 990 ACCOUNTABILITY**

How good is the quality of the reporting now? Not as good as it should be. A recent study found that 30 percent of returns contained mathematical errors. An examination of required attachments found that a fourth of the organizations required to provide additional information failed to do so.

The National Center for Charitable

Statistics at the Urban Institute, Independent Sector, the Association of Fundraising Professionals (formerly NSFRE) and other interested parties have joined forces to improve the quality of reported data and to make the IRS forms and instructions more user-friendly.

Their Quality Reporting Project ([www.qual990.org](http://www.qual990.org)) contains several additional components, including the formation of local collaboratives to promote widespread discussion about nonprofit reporting and accountability, development of technical assistance materials and creation of a demonstration web site that illustrates how a nonprofit might complete and submit a Form 990 electronically.

Many changes are anticipated in the coming years, including allocating more space for the description of program activities. Improvements in the software used to prepare the forms will help eliminate arithmetic and omission errors and prompt the need to attach supplemental statements with all the necessary information.

To keep IRS files more current, organizations that are too small to file Form 990-EZ may be required to complete a "Super" EZ postcard.

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## What Grantmakers Can Learn from Financial Reports Submitted with Proposals

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### Project Budget

- What is the organization trying to do?
- How will the project be structured, staffed and managed?
- Based on what you know about similar projects, do the expenses seem reasonable?
- Are the plans for income realistic?
- Are the expenses and income consistent with the program described in the narrative?
- Does the budget reflect cash flows?

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### Organization-wide Budget

- How does the proposed project budget fit with the organizational budget? Is it in or out of proportion with total costs and income?
- Does the organization as a whole have appropriate income streams and a realistic budget that adequately covers core operating costs?
- How is the budget constructed? Does it reconcile with expected cash flows? How are temporarily restricted funds handled?
- How does the organization monitor budget to actual?

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### Audit

- Does the organization need an annual audit? Does it have one?
- Has the auditor issued an “unqualified opinion” showing that the organization’s financial statements are fairly presented?
- Does the audited balance sheet indicate a sufficiently stable financial context for the project to succeed?

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### Recent Financial Statements

- Is the organization able to issue timely internal financial statements?
- Are there any areas significantly different from the organizational budget or previous financial activity? If so, what are the implications?

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### IRS Form 990

- Has the organization filed a Form 990?
- Do you feel comfortable with the proportions of program, management and general expenses and fundraising costs?

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### Form 990 Schedule A

- Are the salaries of top paid staff reasonable and appropriate?
- Is the list of major contributors, if included, in line with what you otherwise know about the organization?

Source: *Grantmaking Basics: A Guide for Funders*

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## RESOURCES

### Web sites

The most comprehensive collection of scanned 990 forms can be found on the Philanthropic Research Inc. web site ([www.guidestar.org](http://www.guidestar.org)). Another source is the National Center for Charitable Statistics at the Urban Institute site ([www.nccs.urban.org](http://www.nccs.urban.org)).

### Books

If your organization prepares its 990 without the assistance of a CPA, *Completing Your IRS Form 990: A Guide for Tax-Exempt Organizations* by Andrew S. Lang and Michael Sorrels is for you. This line-by-line guide will ensure that your return is accurate and reflects your organization in the best light possible. More detailed texts include *Unified Financial Reporting for Not-for-Profit Organizations* by Russy D. Sumariwalla, Wilson C. Levis and Jan Masaoka, which covers the 990 but also helps nonprofits make sense of and work under GAAP, AICPA and IRS financial reporting guidelines, and *990 Handbook*, Jody Blazek's new book.

How do foundation officers evaluate an applicant's finances? *Grantmaking Basics: A Guide for Funders* by Colburn Wilbur and Barbara Kibbe, published by the Council on Foundations, contains a chapter entitled "Numbers and Sense."

These books and many others on arts law and business practices are available at the **St. Louis Volunteer Lawyers and Accountants for the Arts library** located within the Regional Arts Commission office, 3540 Washington, in Grand Center. The expansion of VLAA's library and promotion of its use is made possible by a generous grant from the Gateway Foundation.